OFFICE OF PROPERTY MANAGEMENT

Hearing on the Proposed Relocation of the Metropolitan Police Department Headquarters to a Leased Facility at 225 Virginia Avenue, S.E. and Potential Future Uses for 300 Indiana Avenue/300 C Street, N.W.

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COMMITTEE ON WORKFORCE DEVELOPMENT AND GOVERNMENT OPERATIONS
Carol Schwartz, Chairperson

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John Wilson Building
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Good day, Chairperson Schwartz and members of the Committee on Workforce Development and Government Operations. I am Lars Etzkorn, Director of the Office of Property Management (OPM). I am pleased to present testimony on behalf of OPM on the proposed relocation of several Metropolitan Police Department (MPD) offices to a leased facility at 225 Virginia Avenue, SE, and the potential future uses for 300 Indiana Avenue, NW.

225 Virginia Avenue, LLC, which is controlled by Williams C. Smith Company, is the fee owner of 225 Virginia. In December 1999, the property was leased to Washington Telecom Associates, LLC, for a term of 60 years. Washington Telecom also has an option to purchase the property.

With Council approval, the Developer, i.e. Washington Telecom Associates, sub-leased the property to the District for 20 years, with one five-year extension option, a subsequent four-year-eleven-month extension option and rights to buy the property at certain points in time. I'll explain the financial terms fully later in my testimony.

To meet MPD's space needs, OPM (on behalf of the District with Council approval), executed a lease for this property on 15 December 2006 on the same day the agreement was approved by Council.

The property at 225 Virginia is a large, flexible building with approximately 421,000 square feet of rentable area and surface parking. It is located in MPD's First District and close to downtown, the current MPD Headquarters and the federal and District Courts, outside high risk areas most likely to be locked down during an emergency.

In July 2006, when its lease was being negotiated, 225 Virginia Avenue was one of five buildings for lease between 370,000 and 570,000 square feet on the market. The Virginia Avenue site, however, was the most flexible of the available properties and most suitable for combined office and non-office uses required by MPD. This is a complicated project to house three distinct police functions – cell-block, secure evidentiary warehouse and office space. Each of these uses must be segregated, including having separate secure entrances. 225 Virginia Avenue was initially used as a newspaper printing plant and later renovated for use as a data center, with new lobbies, elevators, restrooms, electrical and security systems and fire and life safety systems.

OPM negotiated a lease for 225 Virginia Avenue in order to consolidate MPD operations. Current plans call for the Evidence Control Branch, Special Operations Division, Narcotics and Special Investigations Division, Superintendent of Detectives Division, MPD Headquarters offices, and the First District Station to occupy the building.

225 Virginia Avenue served MPD's space needs because the lease for its existing evidence storage facility at 2235 Shannon Place, SE, has expired. Leases for the Violent Crimes Branch at 3220 Pennsylvania Avenue, SE, and Narcotics and Special Investigation Division at 1215 3rd Street, NE, will expire in 2008 and 2010, respectively. In addition, the Special Operations Division is to vacate 2301 L Street, NW, and the First District Station is to

vacate 415 4th Street, SW, in order to make way for the redevelopment of these District-owned properties. Currently, MPD pays an annual rent of $1.4M for space occupied by MPD evidence storage, Violent Crimes Branch, Narcotics and Special Investigation Division and approximately $125K for operating costs at all of these facilities.

The lease, and especially the terms of rent, for 225 Virginia Avenue were structured recognizing that the building would require extensive modification from its then existing condition and that the full extent of the modifications were not known at the time. While certainly MPD knew what components of its operations needed to be relocated, the specific requirements of those programs had not been detailed. With limited availability of options in the market, and knowing there were other parties interested in 225 Virginia Avenue (including CNN, Smithsonian, the Architect of the Capitol and the Department of Justice), OPM negotiated a tiered lease that allowed for a then market justified rate for the as-is base building. The lease also provided, with further Council approval, a means to pay for buildout with a new lease rate to reflect the improved increased value of the property, based on MPD's requirements to follow.

Pre-build out, the annual rent for 225 Virginia Avenue is $6.5M. This amounts to $16.21 per usable square foot prior to paying for the cost of any buildout ($15.44 per existing gross square foot). In addition, the District is responsible for actual operating costs. There is to be no escalation in the rent. The rent is based on a 6.16% rate of return (the then District Bond Yield of 4.38%, multiplied by 1.35 for taxes, plus a risk adjustment of .25%) on a $83M negotiated value of the property (at the time the building was assessed at $86.6M and appraised at $88M). The result was then escalated at an annual rate of 3% over a 20-year period and straight-lined. In Fiscal Year 2007 OPM is paying for the lease from the Swing Space fund; thereafter, MPD will pay for the lease from its operating budget.

The District has an option to purchase the property during the first 5 years of the initial term. If the District exercises its option to purchase the property, the Developer will be required to exercise its purchase option with 225 Virginia Avenue, LLC. The District's purchase option price is $80M to $85M, plus any Developer costs for improvements and costs for exercising the purchase option. If the purchase option is not exercised during the first 5 years, the District will have an option to purchase the property 24 to 18 months prior to the expiration of the initial term. If exercised at the later purchase time, the price is the then market value, plus costs to the Developer for exercising its purchase option.

Subject to further Council approval, the lease provides the District an option to have the Developer fund up to $100M of buildout to the property. The Developer's costs are to be amortized at a rate of 6.5 percent over the remaining 20-year initial term. If the Developer's costs are $100M, it could add approximately $9.2M to the existing base building rent of $6.5M per year or add $22.90 per square foot to the existing annual base building rent of $16.21 per square foot. The total anticipated annual post-buildout rent would then be $15.7M or $39.11 per square foot. Again, there would be no further rent increases. After buildout, assuming operating expenses of $14 per square foot as reported in the Building Owners and Managers

Association's 2006 Experience Exchange Report, the equivalent full service rent for 225 Virginia Avenue would be approximately $53 per square foot.

CoStar, which has the real estate industry's most comprehensive commercial real estate database, reports that in the first quarter of 2007 the average quoted full service Class A office rents in the Capitol Hill submarket (where 225 Virginia is located) were $42.84 per square foot. Currently, near 225 Virginia Avenue there is 204,000 square feet of space planned for 250 M Street, SE, advertised for rents of $44 to $47 per square foot, full service. There is also 190,038 square feet of space at 20 M Street, SE, advertised for $43 to $45 per square foot, full service. Assuming that Capitol Hill submarket rents will escalate at 3-percent annually over a 20-year period (since 2003 the average yearly increase in the Consumer Price Index has been 3.2-percent, which closely mirrors the yearly increase in rents for commercial property), the equivalent flat rent would be approximately $56 per square foot. This compares favorably with the anticipated post-buildout rent for 225 Virginia Avenue of $53 per square foot for specialized space.

We should also consider that police department buildings are typically more expensive to build than office buildings. In fact, RSMeans, which is the leading supplier of construction cost information, indicates that construction costs for police department buildings are 40-percent more than for office buildings.

According to McClaren, Wilson, and Lawrie, a firm specializing in the programming, planning and design of police stations, construction costs for a police station of more than 200,000 square feet being completed this year for the Port of Los Angeles Police Department will be approximately $430 per square foot. Aurora, Illinois opened a police department headquarters building of 152,000 square feet this year with a construction cost of $330 per square foot. In addition, the City of Fairfax, Virginia this year opened a police department headquarters building of 40,000 square feet that had construction costs of $300 per square foot. Office building construction costs in the Washington Area currently average about $200 to $220 per square foot, and the District's Consolidated Forensic Lab construction costs are currently estimated at $440 per square foot.

A $100M buildout for 225 Virginia Avenue would cost approximately $250 per square foot. By reusing an existing structure, we expect to save approximately $100 per square foot. In addition, by renovating an existing structure rather than building new on District-owned land, we cut one and a half years from the schedule.

Pursuant to the terms of the lease, on 9 February 2007, OPM notified the Developer that the District elected to have them complete substantial buildout in accordance with plans and specifications to be developed in cooperation with MPD and approved by OPM. Where applicable, the buildout will adhere to the District's space allocation standards. Since February, the Developer's architect has been meeting once or twice weekly with MPD and OPM to determine the exact programmatic needs, special requirements, space allocations, and adjacency requirements while preparing space plans for the project. Various space and parking configurations have been considered. A test fit plan has been approved, and on 29 May the Developer was directed to proceed with a design for pricing.

Substantial work is needed to convert 225 Virginia Avenue for MPD's multi-use needs including building holding cells, installation of additional elevators, HVAC, electrical distribution and back-up, plumbing and windows. Current plans call for additional office space on the 5th and 6th floors, a grand new main entrance on I Street, SE, in keeping with the majesty of the soon to be built Canal Blocks Park, and a parking garage to be built on the vacant portion of the site.

Originally, all parties thought that within eight months, or by August 2007, we would be able to negotiate a lease amendment for Council consideration to pay for the MPD-required buildout. This was a schedule produced optimistically by a team with no experience planning a retrofit of an existing multi-use building for future police use. The timeframe provided in the lease may have been sufficient for standard office improvements, but the current MPD program calls for holding cells, multiple segregated uses, uninterruptible power, and parking for double the number of vehicles than zoning regulations typically require for office space, as well as other special requirements.

It is anticipated the Developer will complete fifty-percent of the construction documents by September 2007 and have a guaranteed maximum price for the buildout in October 2007. Business terms can then be finalized and a lease amendment will be forwarded to the Council for approval. In the interim, we'll have rough order of magnitude cost estimates from which programmatic refinements may be made but they will not be sufficient to finalize business terms. If Council approves the lease amendment, the

Developer will complete the construction documents, obtain permits, and proceed to construct the proposed improvements.

We certainly recognize the important of 225 Virginia Avenue for pubic safety in the District. Our objective is to make 225 Virginia Avenue available for MPD use as soon as possible; to that end, we are evaluating the possibility of phased occupancy by MPD as early as first quarter 2009 (the entire building will be substantially complete by September 2009).

Our evaluation of phased occupancy is particularly relevant for the part of the building to be occupied by the First District Station. The First District must move from its current location by first quarter 2009 to proceed on schedule with the Combined Forensic Lab at 4th and School Streets, SW. If phased occupancy of 225 Virginia Avenue is found not to be cost effective, OPM is already working with MPD to explore options for placing the First District Station in 10,000 square feet of office space while 225 Virginia Avenue is builtout.

When MPD occupies 225 Virginia Avenue, approximately 170K square feet of office space at 300 Indiana Avenue, NW, will be vacant and available for renovation. In 2011 alone, when the Daly building could be fully renovated, over 480K square feet of leased space will expire. Our planning effort, which is currently underway, is already evaluating the feasibility of relocating agencies to 300 Indiana Avenue.

Thank you for the opportunity to testify. I am pleased to answer your questions.

Summary of Sublease Business Terms
225 Virginia Avenue, S.E.

Leased Premises: Building of approximately 421,000 gross square feet.

Term: 20 years with 2 five-year extension options.

Rent: $6.5 million annually or $16.21 per planned rentable square foot.

Rent Escalation: None.

Rent Abatement: ½ year.

Operating Costs: By tenant. Estimated annual cost of $5.6 million or $14 per square foot after renovation.

Improvements: Up to $100 million of buildout to be provided by landlord, subject to lease amendment and increase in rent ($250 per square foot).

Additional Rent for Improvements: Estimated at $9.2 million, or $22.90 per square foot.

Total Anticipated Annual Rent: $15.7 million, or $39.11 per square foot.

Purchase Option: $80 to $85 million plus cost of improvements or approximately $460 per square foot during first 5 years

225 Virginia Avenue, SE

Schedule & Critical Steps

for MPD Occupancy